ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP - Chairman
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IN THE MATTER OF THE APPLICATION OF MONTEZUMA RIMROCK WATER COMPANY, LLC FOR APPROVAL OF FINANCING TO INSTALL A WATER LINE FROM THE WELL ON TIEMAN TO WELL NO. 1 ON TOWERS.	DOCKET NO. W-04254A-12-0204
IN THE MATTER OF THE APPLICATION OF MONTEZUMA RIMROCK WATER COMPANY, LLC FOR APPROVAL OF FINANCING TO PURCHASE THE WELL NO. 4 SITE AND THE COMPANY VEHICLE.	DOCKET NO. W-04254A-12-0205
IN THE MATTER OF THE APPLICATION OF MONTEZUMA RIMROCK WATER COMPANY, LLC FOR APPROVAL OF FINANCING FOR AN 8,000-GALLON HYDRO-PNEUMATIC TANK.	DOCKET NO. W-04254A-12-0206
IN THE MATTER OF THE RATE APPLICATION OF MONTEZUMA RIMROCK WATER COMPANY, LLC.	DOCKET NO. W-04254A-12-0207
JOHN E. DOUGHERTY, COMPLAINANT, V. MONTEZUMA RIMROCK WATER COMPANY, LLC, RESPONDENT.	DOCKET NO. W-04254A-11-0323
IN THE MATTER OF THE APPLICATION OF MONTEZUMA RIMROCK WATER COMPANY, LLC FOR APPROVAL OF A RATE INCREASE.	DOCKET NO. W-04254A-08-0361
IN THE MATTER OF THE APPLICATION OF MONTEZUMA RIMROCK WATER COMPANY, LLC FOR APPROVAL OF A FINANCING APPLICATION.	DOCKET NO. W-04254A-08-0362 **STAFF'S OPENING BRIEF**

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I. INTRODUCTION

Staff hereby files its opening brief in this consolidated matter. Staff's brief will address, in turn, the factual and procedural background, the three questions posed by the Administrative Law Judge ("ALJ"), Staff's rate case recommendations, and Staff's analysis of the complaint. By way of introducing its position on the consolidated matters, Staff notes that this consolidated matter[1] is complicated and brings together financing of arsenic treatment, rate case recommendations and a nonratepayer complaint.

As the following brief will illustrate, the Staff recommendations are appropriate and reasonable. Further, Staff will explain how the numerous complaint allegations appear to be based on fundamental misunderstandings of the law and are substantially without merit.

II. PROCEDURAL AND FACTUAL BACKGROUND

On May 31, 2012, the Montezuma Rimrock Water Company ("Company" or "MRWC") filed an application for a rate increase and for three separate financing approvals. The Company was required to file a rate application by May 31, 2012 using a test year ending December 31, 2011 by Decision No. 71317 (October 30, 2009).[2] In addition to establishing rates based on current expenses, the application would provide for the recovery of expenses related to servicing the debt that was the subject of the three financing applications.

MRWC is a Class D water utility that serves a community of approximately 221 connections in the vicinity of Rimrock Arizona.[3] The Company acquired its Certificate of Convenience and Necessity ("CC&N") in 2005 from the Montezuma Estates Property Owners Association ("MEPOA") in Decision No. 67583 (February 15, 2005).

The Company is located in an area where arsenic contamination is present in the aquifers that provide the water used to serve customers. Pursuant to a rulemaking by the US Environmental

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[1] For clarity, prior to the consolidation of all dockets in this matter, Staff will refer to the W-04254A-12-0204, W-04254A-12-0205, W-04254A-12-0206, and W-04254A-12-0207 dockets as W-04254A-12-0204 *et. seq.* and following the consolidation of all dockets, Staff will refer to the fully consolidated matter as consolidated Docket No. W-04254A-12-0204.

[2] Decision No. 71317 at 21.

[3] Transcript of June 20, 2013 evidentiary hearing at 69:24-70:5. Hereafter, all references to the transcript of the evidentiary proceeding will be referred to as "Tr." and transcripts of other proceedings will be distinguished by their docket number and date.

Protection Agency that became effective January 22, 2001[4], the amount of acceptable arsenic levels in drinking water supplies was reduced from 50 parts per billion to 10 parts per billion. As part of its plan to achieve compliance with the arsenic standard, MRWC drilled a new well at substantial cost that was located on a lot within the development served by MRWC. In order to obtain funds to develop a treatment system to remove the arsenic from this well, known as Well No. 4, the Company applied for a rate increase and approval to incur $165,000 in debt through the Water Infrastructure and Financing Authority of Arizona ("WIFA").[5]

The Commission ultimately approved the Company's application and a surcharge mechanism to fund the debt service on the WIFA debt in Decision No. 71317.[6] However, as the processing of the financing application at WIFA progressed, the Company became, to Staff's knowledge, the first utility ever required by WIFA to perform a National Environmental Protection Act ("NEPA") environmental information document. The purpose of requiring the additional NEPA process was that the WIFA loan would be provided using federal money and Well No. 4 is near to the outermost boundary of the Montezuma's Well National Monument.

Due to the prohibitive cost of performing the required NEPA analysis, the Company applied to the Commission to modify Decision No. 71317.[7] The requested modification would grant the Company more time to pursue other means to comply with a requirement that it obtain an Approval of Construction ("AOC") from the Arizona Department of Environmental Quality ("ADEQ") for the arsenic treatment facilities.[8] Staff prepared a Staff Report recommending approval of the request.[9] The Hearing Division prepared a recommended opinion and order that would have granted the requested modification to Decision No. 71317.[10]

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[4] 66 FR 6976.
[5] Application in Docket No. W-04254A-08-0361 & financing W-04254A-08-0362.
[6] Decision No. 71317 at 21-22.
[7] Letter from Patricia Olsen dated December 10, 2009 filed in Docket No. W-04254A-08-0361.
[8] *Id.*
[9] Staff Memorandum filed February 3, 2010 in Docket No. W-04254A-08-0361.
[10] Recommended Opinion and Order of the Hearing Division filed February 11, 2010 in Docket No. W-04254A-08-0361.

In the course of processing the request to grant the extension request, a property owner[11] within the MRWC service territory, Mr. John Dougherty, filed exceptions to the recommended opinion and order.[12] At the Open Meeting held on March 2 and 3, 2010, the Commission voted to not approve the recommended opinion and order. On January 24, 2011, the Company filed formally for an amendment to Decision No. 71317 under A.R.S. § 40-252 for permission to obtain debt financing from an entity other than WIFA.[13] Staff filed a Staff Report on February 10, 2011, making no recommendation but noted that private financing could save ratepayer money by avoiding the need to undergo a NEPA process.[14] During the April 27, 2011 Staff Open Meeting, the Commission voted to reopen Decision No. 71317 to consider modifying the financing approval and associated provisions (hereafter "40-252 Proceeding").

On June 9, 2011, Mr. Dougherty filed for intervention in the 40-252 Proceeding. The request was granted by procedural order on June 29, 2011.

During the course of the 40-252 Proceeding, the Company investigated several private lending institutions as alternative means to finance the construction of the required arsenic treatment facilities. Mr. Dougherty expressed concerns with the operations of MRWC, particularly the effects of the Company's Well No. 4 on the Montezuma's Well National Monument.[15] To that end, Mr. Dougherty filed a motion on July 20, 2011 to compel Staff to initiate an Order to Show Cause ("OSC") proceeding against the Company.[16]

A procedural conference was held on July 22, 2011.[17] In addition to speaking to the feasibility of alternative paths forward, Staff was asked to explain why Staff was not pursuing some form of enforcement against the Company regarding issues identified by Mr. Dougherty. Staff

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[11] While Mr. Dougherty owns a property within the MRWC service territory, it appears that the property has been used for rental purposes on an intermittent basis. Tr. at 785-788. Further, Mr. Dougherty is not a ratepayer of the Company as his lot is served by a private well. *Id.* at 763.

[12] Exceptions filed by Mr. Dougherty on February 19, 2011 in Docket No. W-04254A-08-0361.

[13] Letter from Patricia Olsen dated January 23, 2011 filed in Docket No. W-04254A-08-0361.

[14] Staff Report filed February 10, 2011 in Docket No. W-04254A-08-0361.

[15] *See, e.g.,* Exceptions filed on February 19, 2010 in Docket No. W-04254A-08-0361.

[16] Motion for Order Directing Staff to File Order to Show Cause filed on July 20, 2011 in Docket No. W-04254A-08-0361.

[17] Staff notes that this is the first of two procedural conferences wherein injunctive orders interrupted the process. Tr. of July 22, 2011 procedural conference at 3-10, Docket No. W-04254A-08-0361.

observed that the Company appears to be working to address its compliance issues.[18] Owing to the limitations of the 40-252 Proceeding as a vehicle to address his concerns, Mr. Dougherty was encouraged to pursue his own application where his concerns could be resolved.[19]

Shortly thereafter, the Company filed an application for emergency rates to fund debt service on potential private loans to use in the alternative to a WIFA loan.[20] Mr. Dougherty was granted intervention in the emergency Rate Application by procedural order dated August 12, 2011. A procedural conference was held on August 10, 2011. During the procedural conference parties discussed the procedure and scope of an emergency rate case. Staff explained the requirements for an emergency rate case, the protections built into the process[21] and forecasted that the purposes of MRWC's application would not ordinarily constitute an emergency. [22] Staff further mentioned that, in light of the Company's investigation into the feasibility of private financing for the arsenic treatment a more advantageous route might be to press forward in the 40-252 Proceeding.[23] The goal in that alternative would be to substitute a different lender than WIFA into the approval granted by Decision No. 71317 and thereby apply the already approved surcharge mechanism to service debt from a substitute lender upon Commission approval.

Mr. Dougherty filed a formal complaint concurrent with the processing of the emergency rate case on August 23, 2011.[24] The original complaint enumerated 15 counts that expressed a wide variety of concerns with the management of MRWC and alleged violations of requirements of the Commission as well as WIFA and ADEQ. (Hereafter, the complaint matters will be referred to as the "Complaint Proceeding").

On August 30, 2011, Mr. Dougherty filed a motion to stay the processing of the emergency rate case in order to permit the Complaint Proceeding to go first. Shortly thereafter, Staff filed its Staff Report in the emergency rate case. In it, Staff recommended denying the emergency rate

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[18] *Id.* at 24.
[19] *Id.* at 36-37.
[20] *See* Emergency Rate Case application filed July 25, 2011, Docket No. W-04254A-11-0296.
[21] Tr. of August 10, 2011 procedural conference at 7; Docket No. W-04254A-11-0296.
[22] *Id.* at 19-20.
[23] *Id.* at 38-39.
[24] Formal Complaint under A.R.S. § 40-246 and Arizona Corporation Commission Rules and Procedures R14-3-106 against Montezuma Rimrock Water Company LLC and Managing Member Ms. Patricia Olsen, Docket No. W-04254A-11-0323, filed August 23, 2011.

increase due to Staff's view that the Company failed to demonstrate the existence of any of the three criteria to establish an emergency.[25] The next day, a joint procedural conference was held in the 40-252 Proceeding, the Complaint Proceeding and the emergency rate case proceeding to discuss whether the emergency rate case could proceed. Staff opined that the emergency rate case could proceed as the complaint only requested cancellation of MRWC's CC&N. As MRWC would remain a public service corporation regardless of whether its CC&N was deleted, the Company would remain subject to Commission rate regulation and so the emergency rate case could proceed.[26] Following the procedural conference, Mr. Dougherty filed on the same day, a motion to amend his complaint to add one additional allegation and two additional remedies, including the installation of an interim manager.[27]

The emergency rate case proceeded to a hearing that was held on September 22, 2011. However, the hearing stalled shortly after the public comment phase due to persistent concerns whether the matter could proceed. The matter was continued pending the filing of updated materials by the Company and Staff was required to provide an amended Staff Report evaluating those materials. The Company ultimately requested to withdraw the emergency rate filing[28] and Mr. Dougherty, although opposed to the emergency rate increase and having previously requested a stay of the proceeding, then filed a motion to deny the Company's withdrawal of its emergency rate application.[29] The withdrawal was granted by procedural order on October 12, 2011.

The same day, a procedural order was issued in the Complaint Proceeding ordering Staff to fully participate and to formulate a position on all the allegations raised by Mr. Dougherty.[30] Likewise occurring that same day, the Company filed its current plan to resolve its arsenic issues. In the filing, MRWC indicated that it intended to fund the necessary treatment plant with an operating lease and as such would no longer require Commission approval of debt to finance the construction.[31]

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[25] Staff Report filed September 12, 2011at 2-3, Docket No. W-04254A-11-0296.
[26] Tr. of September 13, 2011 Procedural Conference at 10-11, Docket No. W-04254A-11-0296.
[27] Motion to Modify Complaint filed September 13, 2011, Docket No. W-04254A-11-0323.
[28] Motion to Withdraw Emergency Rate Application filed September 29, 2012, Docket No. W-04254A-11-0296.
[29] Motion to Deny Motion to Withdraw Emergency Rate Application filed October 3, 2011, Docket No. W-04254A-11-0296.
[30] Procedural Order dated October 12, 2011 at 4, filed in Docket No. W-04254A-11-0323.
[31] MRWC Notice of Filing Arsenic Abatement Plan, filed October 12, 2011 in Docket No. W-04254A-08-0361.

A subsequent procedural conference[32] was held on October 25, 2011 in the Complaint Proceeding. Staff, through counsel, orally provided its preliminary view of the allegations expressed within the complaint, as amended and assuming, with the exception of two counts, that all material facts were resolved in favor of Mr. Dougherty. Staff provided its analysis of the allegations, which concluded that even if the alleged facts were resolved in favor of Mr. Dougherty,[33]none of the allegations expressed a claim, the claims had not ripened, or Mr. Dougherty was not a proper party to raise the claim.[34] Additionally, Staff reiterated the view that it would not, in its discretion, seek enforcement against MRWC at the time as Staff viewed enforcement against a utility that is expending substantial effort to comply as counterproductive to achieving ultimate compliance and further that an interim manager would face the same regulatory problems confronting MRWC.[35]

Following that procedural conference, Staff provided its analysis of the Company's proposal to fund the arsenic treatment plant by means of an operating lease.[36] Shortly thereafter, Mr. Dougherty made a filing accusing Staff of violating the *ex parte* rule by communicating informally with the Company.[37] Mr. Dougherty thereupon filed a motion to amend his Complaint to add an allegation that the Company violated *ex parte*.[38] Staff responded to the effect that litigation Staff is not the decision maker and as such *ex parte* is not implicated by discussions with the Company. A procedural order issued on November 9, 2011 ruled on various discovery motions as well as denying the motions relating to the alleged *ex parte* communication.

Likewise, the Company was directed to provide copies of the operating leases for evaluation.[39] The Company provided a partial response but did not provide copies of the operating leases.[40] Shortly thereafter the Company's attorney filed a motion to withdraw, citing mounting legal expenses to MRWC.[41] Ms. Patricia Olsen filed the same day a motion to have Mr. Dougherty

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[32] This procedural conference was also noteworthy as the second instance where an injunctive order disrupted the proceeding. Tr. of October 25, 2011 Procedural Conference at 29-42 in Docket No. W-04254A-11-0323.
[33] *Id.* at 56-57.
[34] *Id.* at 42-54.
[35] *Id.* at 7-8.
[36] Staff Response to Procedural Order filed October 31, 2011, Docket No. W-04254A-08-0361.
[37] Motion to Investigate Ex Parte Communications filed on November 2, 2011, Docket No. W-04254A-08-0361.
[38] Motion to Add Ex Parte Allegation to Complaint filed November 7, 2011, Docket W-04254A-11-0323.
[39] Procedural Order filed November 9, 2011 at 7, Docket No. W-04254A-08-0361.
[40] Interim Report filed December 7, 2011, Docket No. W-04254A-08-0361.
[41] Motion to Withdraw filed January 6, 2012, Docket No. W-04254A-08-0361.

"removed as an intervenor".[42] On February 21, 2012, copies of a lease from Kevlor were docketed without cover letter.[43] By March 9, 2012, the Company had engaged new counsel to represent it in the Complaint Proceeding and the 40-252 Proceeding. Based on the change in attorney, a procedural order issued that permitted the Company's original attorney to withdraw, as well as requiring MRWC to docket any executed leases by March 30, 2012.[44]

A week after that procedural order issued, a packet including a Water Services Agreement ("WSA") between Ms. Olsen and MRWC as well as copies of leases with Nile River Leasing and Kevlor were docketed.[45] Parties were called upon to evaluate whether the leases were operating leases or capital leases. Staff[46] and Mr. Dougherty[47] both took the position that the WSA described a capital lease. At a procedural conference held on April 30, 2012, the Company observed that it could redo WSA as an operating lease if in fact the WSA was a capital lease.

Rather than renew efforts to amend Decision No. 71317 to permit the Company's acquisition of new debt via the capital leases it had entered into, MRWC filed a new general rate case, which it was already required to do by the terms of Decision No. 71317 on May 31, 2012. (The 2012 general rate case application will hereafter be referred to as the "Rate Application"). The Rate Application sought a $43,400 revenue increase, or 42.85 percent above test year revenues of $101,276 to $144,676. In addition to a base rate increase, the application sought various new surcharges to cover the cost of replacing storage tanks and to cover growing legal expenses.

Separately, the Company filed three financing applications. The financings were to obtain approval for (1) $68,592 to pay for a water line connecting Well No. 4 to Well No. 1;[48] (2) $21,000 to pay for the Well No. 4 site and a new vehicle for the Company;[49] and (3) $15,000 to pay for an 8,000 gallon hydro-pneumatic tank.[50] Mr. Dougherty was granted intervention by procedural order.[51] By

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[42] Request to Have John Dougherty Removed as Intervenor filed January 6, 2012, Docket No. W-04254A-08-0361.
[43] Untitled Filing filed February 21, 2012, Docket No. W-04254A-08-0361.
[44] Procedural Order dated March 12, 2012, filed in Docket No. W-04254A-08-0361.
[45] Although there was no notice of filing or cover letter, the filing is assumed to have been made by Ms. Olsen, acting in the Company's behalf. Untitled filing made March 19, 2012 in Docket No. W-04254A-08-0361. The same documents were refilled on April 13, 2012 by counsel on behalf of MRWC in the same docket.
[46] Staff Report filed April 27, 2012, Docket No. W-04254A-08-0361.
[47] Dougherty Response filed April 27, 2012, Docket No. W-04254A-08-0361.
[48] Financing Application filed in Docket No. W-04254A-12-0204.
[49] Financing Application filed in Docket No. W-04254A-12-0205.
[50] Financing Application filed in Docket No. W-04254A-12-0206.

separate procedural order dated July 24, 2012, the financing applications were consolidated with the Rate Application. RUCO filed a motion to intervene in the Rate Application shortly after the matter was found sufficient.[52]

Representing the Company, Ms. Olsen filed an amendment to the Rate Application to request a surcharge for a storage tank as well as a legal defense surcharge.[53] An identical amendment to the Rate Application was again filed on December 3, 2012. A day later, Ms. Olsen filed a motion to withdraw the WIFA modification request and all filing requirements relating to the 40-252 Proceeding.[54] Simultaneously, Ms. Olsen filed copies of an ADEQ Partial AOC for the arsenic treatment facility MRWC had constructed[55] as well as a request for extension to comply with the Decision No. 71317 requirement for an AOC for Well No. 4.[56] In response, Mr. Dougherty filed a motion to bar the filings as violative of a prior procedural order.[57] Mr. Dougherty simultaneously filed a motion to (1) hold MRWC in contempt, (2) bar MRWC from expending its money to pay the capital leases, (3) require Ms. Olsen to refund to MRWC funds expended to pay the capital leases, (4) refer Ms. Olsen/MRWC to the attorney general for criminal investigation, and (5) revoke MRWC's CC&N.[58]

A procedural order dated February 1, 2013 ordered that the filings made by Ms. Olsen would be disregarded as improper. However, the procedural order also denied the motion to hold MRWC in contempt as well.[59] A joint procedural conference was held on February 25, 2013 regarding parties' procedural recommendations in light of the three active matters. In addition, Mr. Dougherty was charged with redoing his complaint[60] and RUCO was asked if it intended to intervene in the

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[51] Procedural Order dated June 25, 2012, Docket No. W-04254A-12-0204 *et seq.*
[52] RUCO Motion to Intervene dated November 9, 2012 filed in Docket No. W-04254A-12-0204 *et seq.* The request was granted by Procedural Order dated November 23, 2012.
[53] Rate case amendment filed on November 26, 2012, Docket No. W-04254A-12-0204 *et seq.*
[54] WIFA Loan Request Withdrawal filed on December 4, 2012, Docket No. W-04254A-08-0361.
[55] Approval of Construction Partial Approval filed December 4, 2012, Docket No. W-04254A-08-0361.
[56] Approval of Construction For Well #4 Extension filed December 12, 2012, Docket No. W-04254A-08-0361.
[57] Motion to Bar Filings filed January 14, 2013, Docket No. W-04254A-08-0361.
[58] Motion filed January 14, 2013, Docket No. W-04254A-12-0204 *et seq.*
[59] Procedural Order dated February 1, 2013 at 2-3, Docket No. W-04254A-08-0361.
[60] Tr. of Joint Procedural Conference held February 25, 2013 at 41, Docket No. W-04254A-08-0361.

Complaint Proceeding and 40-252 Proceeding.[61] A procedural order issued the next day consolidated the Rate Application with the 40-252 Proceeding and the Complaint Proceeding.

A day after the consolidation, Mr. Dougherty filed his amended complaint which added one new allegation and eliminated several of the previous allegations made in the original complaint and subsequent amendments.[62] Meanwhile, RUCO filed a notice of withdrawal as an intervenor[63] to which Mr. Dougherty filed a motion to bar the withdrawal.[64] RUCO's withdrawal was granted by procedural order dated March 21, 2013.

Subsequently, MRWC amended its financing applications.[65] The amended applications sought approval to finance the construction of four 20,000 gallon storage tanks with a WIFA loan, approval of the debt associated with the Nile River Leasing lease for the arsenic treatment building, and approval of the debt associated with the Financial Pacific Leasing lease for the arsenic treatment facility.[66]

Days later, at a procedural conference to discuss one of the many discovery disputes between the Company and Mr. Dougherty, Staff and the Company articulated their view that the amended financing applications were to correct the original financing applications rather than new financing applications.[67] The same day, Mr. Dougherty filed a motion for summary judgment on the basis that MRWC had not filed versions of the lease agreements that were executed on March 22, 2012 (as opposed to the versions that were purportedly executed on March 16, 2012 and filed on March 19, 2012 and again on April 13, 2012).[68] The motion was denied by procedural order on May 24, 2013.[69]

Mr. Dougherty filed direct testimony on May 22, 2013. Staff and the Company filed direct testimony on May 24, 2013. All parties filed responsive testimony on June 6, 2013. Mr. Dougherty's

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[61] *Id.* at 29-30.
[62] Amended Formal Complaint and Motion to Add Allegation XVII filed February 27, 2013, consolidated Docket No. W-04254A-12-0204.
[63] RUCO Notice of Withdrawal of Intervention filed March 12, 2013, consolidated Docket No. W-04254A-12-0204.
[64] Motion to Bar RUCO's Withdrawal filed March 18, 2013, consolidated Docket No. W-04254A-12-0204.
[65] Amended Financing Applications filed April 12, 2013, consolidated Docket No. W-04254A-12-0204.
[66] *Id.*
[67] Tr. of Procedural Conference held April 15, 2013 at 4-5, consolidated Docket No. W-04254A-12-0204.
[68] Motion for Partial Summary Judgment filed on April 15, 2013, consolidated Docket No. W-04254A-12-0204.
[69] Procedural Order filed May 24, 2013, consolidated Docket No. W-04254A-12-0204.

Direct Testimony focused substantially on matters raised within the Complaint Proceeding and portions were struck as legal argument rather than evidentiary testimony at the pre-hearing conference held on June 14, 2013.

Staff's Direct and Responsive Testimony focused on its recommendations relating to the Rate Application. Staff recommends a more modest revenue increase of $27,946 or a 27.59 percent increase over test year revenues. While the Staff recommendation will provide the Company with sufficient revenue to cover its operating expenses, the additional revenue above expenses provides a margin of $2,771 for a 4.11 percent rate of return on Staff's recommended fair value rate base of $67,414.[70] Staff further recommends approval of two surcharges for the purpose of funding debt related to the acquisition of the hydro-pneumatic tank and the construction of 80,000 gallons of new storage. Additionally, Staff recommends termination of the requirement established by Decision No. 71317 that the Company maintain a performance bond. For the reasons expressed in the discussion below, Staff's recommendations are reasonable and appropriate and should be adopted by the Commission.

III. DISCUSSION

In addition to discussing Staff's recommendations and views with regard to the Rate Application, Staff will address three questions posed by the Administrative Law Judge ("ALJ") to all parties. Although Staff is not the subject of Mr. Dougherty's complaint, Staff is a party to the Complaint Proceeding as well and was previously asked to provide its view of the complaint allegations. As such, Staff will provide an updated analysis of the issues raised by the complaint as part of its Discussion as well.

A. Staff's Analysis of ALJ Requested Issues

During the evidentiary hearing, the ALJ directed parties to evaluate three questions. The first was whether the Company's failure to obtain prior Commission approval before incurring new debt triggered language within Decision No. 67583, which granted MRWC its CC&N, that would render the CC&N null and void. The second question was whether the Commission possesses the authority

[70] By using the Water Rate Application Checklist form, the Company agreed to the use of its Original Cost Rate Base as the Company's Fair Value Rate Base. Application, attached Water Rate Application Checklist at 6, consolidated Docket No. W-04254A-12-0204.

to grant retroactive approval of the long term debt that MRWC has incurred. The final question was whether the Commission has the authority to penalize the Company or Ms. Olsen personally for violation of Commission statutes, rules, and orders, including procedural orders.

With regard to the first question, in brief, Staff believes that the CC&N granted to MRWC by Decision No. 67583 is not rendered null and void solely by the Company's failure to gain prior Commission approval before entering into long term debt. As to the second question, Staff believes that the Commission has the authority to make necessary determinations for the well-being of public service corporations and their ratepayers, including issuing retroactive approvals of debt incurred for the purpose of complying with health and safety requirements. Finally, with respect to the third question, the Commission has a wide array of authority to enforce compliance with its rules and orders that may apply as appropriate to either MRWC, Ms. Olsen or both.

1. Whether MRWC's not having obtained prior Commission approval before encumbering assets of the utility or taking on long term debt renders the approvals granted in Decision No. 67583 null and void or otherwise does or should impact the approvals granted therein including MRWC's CC&N

The Company acquired its CC&N from MEPOA in 2005 by order of the Commission in Decision No. 67583. One of the conditions of the order was that the Company not encumber the assets of the utility in any way without prior Commission approval.[71] Further, the order provides that violation of the established conditions will render the granted approvals null and void.[72]

Mr. Dougherty's complaint, as amended, contains various requests for relief. However, it was not until the filing of direct testimony in the consolidated matter that Mr. Dougherty for the first time requested in writing that the Company's entry into two separate long term debts be determined as the encumbrances prohibited by Decision No. 67583.[73] On that basis, Mr. Dougherty requested for the first time that the Commission rescind the grant of the CC&N to MRWC.[74] In making the request, Mr. Dougherty appears to be operating under the impression that the CC&N will simply revert back

[71] Decision No. 67583 at 9.
[72] *Id.* at 11.
[73] Dougherty Dir. Test., Ex. C-92 at 15.
[74] *Id.*

to MEPOA or that it can be cancelled without further action. Neither of those outcomes is procedurally possible in this case.

Initially, Staff would observe that the complaint, as amended, does not include an allegation that the Company has violated Decision No. 67583 by encumbering assets of the utility without prior Commission approval.[75] In light of the significance of a complaint as an instrument to inform an opposing party as to the allegations it must be prepared to refute, particularly in light of the punitive character of the potential outcome if the relief is granted, Staff has concerns that MRWC was not adequately noticed that its CC&N might be rescinded on this basis.

Even if MRWC is determined to have been adequately placed on notice of the potential rescission of its CC&N, Mr. Dougherty has clearly failed to meet the heavy burden necessary to delete the Company's CC&N. Once granted, a CC&N holder is entitled to retain their CC&N so long as it provides adequate service at reasonable rates.[76] The record evidence in this matter is that not only is MRWC providing adequate service, the service is superior to what it was when MEPOA held the CC&N.[77]

Mr. Dougherty's request that the CC&N be rescinded pursuant to an alleged violation of Decision No. 67583 clearly cannot be granted on the evidence provided at hearing. The uncontroverted evidence is that MRWC provides superior service to MEPOA.[78] Consequently, rescission of the CC&N would be directly at odds with the requirements of *James P. Paul.*

The matter is further procedurally muddied because MEPOA is not a party to this proceeding. Due to the obligations that come with acquiring a CC&N, it cannot be taken as a given that an entity is willing to accept a CC&N without its express statement to that effect. In order to rescind the grant of CC&N transfer, MEPOA would have to be joined as a party to advocate for its position on potentially receiving all of the obligations that come with possessing a CC&N.

Mr. Dougherty has alternatively requested that Arizona Water Company ("AWC") receive the CC&N once the original transfer to MRWC is revoked.[79] This variation suffers from the same

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[75] *See* Amended Formal Complaint filed February 27, 2013, consolidated Docket No. W-04254A-12-0204.
[76] *James P. Paul v. Arizona Corporation Commission*, 137 Ariz. 426, 429, 671 P.2d 404, 407 (1983).
[77] Tr. at 696-98.
[78] *Id.*
[79] Dougherty Resp. Test., Ex. C-93 at 25.

procedural defect as would rescinding the CC&N transfer from MEPOA. AWC is not a party to this proceeding and cannot have new CC&N obligations, including for new territory, foisted on it in its absence. Moreover, the record has been clear that AWC is unambiguously not interested in acquiring MRWC's service territory under the present circumstances.[80]

Therefore, rescinding the CC&N is not appropriate based on the record that has been established during this proceeding, even if the procedural challenges are resolved.

2. Whether the Commission has the authority to grant retroactive approval to long term debt of a Public Service Corporation

In response to concerns related to the Company's incurring debt without prior Commission approval, it has been accurately stated that the Commission has often provided retroactive approval of debt.[81] The significance of the frequent resort to this practice is that it demonstrates that the Commission has often found that a utility's assumption of debt was to the public benefit in the provision of utility service, notwithstanding the failure to obtain Commission approval beforehand.

Staff would note that the relevant statutory provisions, A.R.S. §§ 40-301 and -302, do not prohibit the issuance of retroactive approval or express a limitation on the Commission's approval authority in any respect. Rather, A.R.S. §§ 40-301 and -302 speak to the obligations of the ***utility*** to obtain Commission approval.

> **A public service corporation** may issue stocks and stock certificates, bonds, notes and other evidences of indebtedness payable at periods of more than twelve months after the date thereof, **only when authorized by an order of the commission**.

A.R.S. § 40-301(B) (emphasis added). The statute likewise fails to place time limits on the Commission's ability to grant such approval.

To the extent that some readings of the statutory text may produce the conclusion that the statutes prevent retroactive debt approvals, Staff would contend that such a construction would render the statute unconstitutional. As noted above, the Commission has often found it appropriate for the public convenience, health and safety to permit utilities to incur debt so as to forestall impending

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[80] *See, e.g.,* Exhibit A-24, email from William Garfield to Todd Wiley; Exhibit S-1, attached Memorandum of Marlin Scott at 20, paragraph G.

[81] *See, e.g.,* Decision No. 73156 (May 18, 2012) at 4-6, Decision No. 72667 (November 17, 2011) at 10-11, Decision No. 70698 (January 20, 2009) at 8-9, 13, Decision No. 70171 (February 27, 2008) at 4-6, Decision No. 65853 (April 25, 2003) at 11, Decision No. 58422 (October 18, 1993) at 4-5.

calamities that would disrupt service. In so doing, the Commission has found it appropriate for the utilities in question to obtain rate recovery for those debts so as not to financially hinder the utility for undertaking such debts.

The Constitution provides the Commission with plenary authority to set rates and take any necessary step in the ratemaking process, including approving debt that is to be funded by the rates the Commission approves.[82] To the extent that A.R.S. §§ 40-301 and -302 suggest that the Commission's authority is confined with respect to financings, the statutes would be curbing the Commission's constitutionally exclusive ratemaking authority and would thereby be in conflict with the Constitution. A basic canon of statutory construction is that statutes must be read, if at all possible, in a light that produces a lawful result. Reading A.R.S. §§ 40-301 and -302 to mean that the Commission is proscribed from granting retroactive approval to debt would mean that the statutes are unconstitutional.

Consequently, Staff believes that the Commission has the authority pursuant to the ratemaking authority and broad general regulatory authority articulated in Article XV, Section 3 of the Constitution to grant retroactive approval and rate recovery of debts that were incurred without prior Commission approval.

3. Whether the Commission has the authority to and should impose fines and other penalties on MRWC or Ms. Olsen personally for noncompliance with statutes, Commission decisions, and procedural orders

Mr. Dougherty has alleged that the Company has violated several statutes and rules administered by the Commission. Among the issues raised by Mr. Dougherty is that the Company entered into lease agreements that it did not disclose as required by a procedural order.[83]

The Commission has several sources of fining authority, both constitutional (art. XV, §§ 16, 19) and statutory (A.R.S. §§ 40-424, -425). Under Article XV, Section 19, the Commission has the power to assess fines to enforce its rules, regulations, and orders in an amount it deems just. Under Article XV, Section 16, public service corporations that violate any of the Commission's regulations, orders, or decisions shall forfeit to the State not less than $100 nor more than $5,000. A.R.S. § 40-

[82] *Arizona Corp. Comm'n v. State ex rel. Woods*, 171 Ariz. 286, 294, 830 P.2d 807, 815 (1992).
[83] Dougherty Dir. Test., Ex. C-92 at 15.

424 enlarges the Commission's authority, empowering the Commission to fine any corporation or person that acts in contempt of the Commission's orders, rules, or requirements. A.R.S. § 40-425 also enlarges the Commission's authority, allowing the Commission to assess fines for violations not otherwise provided for, such as specific violations of the constitution or of Title 40. A.R.S. § 40-428 provides that all of these penalties may be cumulative.

If the Commission were to determine that the facts of this case demonstrate the violation of Commission rules, statutes or decisions, it has the authority to issue fines pursuant to its statutory and constitutional authority. There is a separate issue raised with respect to the alleged violation of a procedural order in that it was issued by an ALJ rather than the Commission. Staff has been unable to find any authority that provides a direct answer to this issue.

Staff believes, however, that there is a colorable argument that the ALJ, sitting as the Commission's hearing officer to preside over an evidentiary hearing could, in a recommended order, recommend that the Commission find either Ms. Olsen or MRWC in contempt for violation of a procedural order. By virtue of A.R.S. § 40-424, the Commission has contempt authority. Staff likewise contends that a procedural order may constitute an order of the Commission in the sense that an ALJ is acting on behalf of the Commission pursuant to a delegation of authority to conduct hearings for the Commission.

Regarding whether the Company or Ms. Olsen should be penalized for any violations in relation to matters expressed within this proceeding, Staff has been asked previously whether it would pursue a complaint or an order to show cause against the Company. Staff has consistently asserted that it is not pursuing enforcement at this time so long as the Company is making efforts to come into compliance.

Enforcement is an inherently discretionary function and it falls within Staff's discretion to pursue any particular violation as a candidate for enforcement action. Staff must consider the resources at its disposal and the resources that must be expended. The testimony is uncontroverted that conditions are better than they were when MRWC assumed the operations of the water system and that they are improving still.[84]

[84] Tr. at 696-98.

In Staff's view, this is not a suitable candidate for enforcement. Pursuing enforcement in this context would send a message that Staff assists struggling utilities only to assail them when they are on the precipice of achieving compliance. Staff has an interest in being able to work with utilities to achieve compliance using means short of initiating enforcement actions. Moreover, enforcement actions do not always accelerate the process of achieving ultimate compliance owing to the tendency of the subject utility to devote its resources to defending the enforcement action rather than curing the issue that prompted the noncompliance. This concern is particularly acute in the case of small class D and E water utilities and is illustrated here by the extraordinary degree of legal expenses incurred by the Company in the present case in proportion to the overall revenue requirement.

B. Staff's Rate Case Recommendations

The Company agreed with Staff's rate case recommendations as set forth in the Responsive Testimony of Gerald W. Becker with three minor exceptions that were later resolved during the hearing in this matter.[85] Staff recommends a revenue increase of $27,946 or 27.59 percent over the test year revenues of $101,276. This produces a revenue requirement of $129,222. As discussed above, Staff is recommending that the rates in this matter be set based on a cash flow analysis. Through this analysis, this increase in the test year revenues would produce an operating income of $2,770 for a 4.11 percent rate of return on the adjusted original cost rate base of $67,414 that is recommended by Staff.

Additionally, Staff is recommending approval of two surcharges to recover debt service associated with the acquisition of an 8,000 gallon hydro-pneumatic tank and construction of 80,000 gallons of new storage as well as a portion of the debt associated with the arsenic treatment system and the building that houses it. Staff recommends denial of debt recovery related to interconnecting Well No. 4 to the Company's water system, as well as for the well site as those were not determined to be used and useful. Staff is further recommending denial of recovery on debt associated with a company vehicle as it is already included within rate base.

1. Rate Base

[85] Tr. at 412-13.

As indicated above, Staff is recommending an original cost rate base of $67,414. This recommendation is based on the following eleven rate base adjustments in this case.[86]

a. Plant in Service

Staff decreased the Company's Plant in Service ("PIS") by $91,286 from $570,636 to $479,350.[87] A large portion of this adjustment is related to the removal of Well No. 4 and associated improvements from PIS because the well is not currently used and useful. More specifically, this adjustment is comprised of adjustments to Land and Land Rights, Structures and Improvements, Wells and Springs, Pumping Equipment, Water Treatment Equipment and Water Treatment Plant, and Distribution Reservoirs & Standpipes and Storage Tank.

PIS Adjustment A decreases the land and land rights account by $37,000 to $0. This adjustment removes the amount the Company spent to purchase the site for Well No. 4 from PIS. Since Well No. 4 is not in service, the cost associated with the purchase of the well site is properly removed from PIS.[88]

PIS Adjustment B increases the structures and improvements account by $8,000 from $38,595 to $46,595. This adjustment increases the structures and improvements account to include $8,000 the Company spent constructing the building that houses the ATS that was not recorded by the Company in its test year PIS amounts.[89]

PIS adjustment C decreases the wells and springs account by $42,755, thereby decreasing the balance in this account from $84,265 to $41,510. This adjustment reflects the $49,584 balance established in Decision No. 71317 less $8,074 relating to Well No. 2 that the Company removed from service since that proceeding.[90]

PIS adjustment D decreases the pumping equipment account by $24,999 from $63,263 to $38,264. This adjusted amount reflects the $36,556 balance established in Decision No. 71317 plus $1,708 for several additions.[91]

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[86] Becker Dir. Test., Ex. S-1 at 10.
[87] *Id* at 12.
[88] *Id.*
[89] *Id.*
[90] *Id.*
[91] *Id.*

PIS Adjustment E decreases the Water Treatment account by $7,386, from $7,386 to $0 in order to transfer this balance to the Water Treatment Plant. PIS Adjustment F increases the Water Treatment Plant account by $7,386 plus 37 percent of the cost of the ATS, or $8,036, for a total of $15,422. The cost of the ATS is based on the $38,000 the Company requested in its application, less $16,280 for the media costs included in the $38,000 for a total cost of $21,720. This amount is then multiplied by the 37 percent utilization rate to arrive at the $8,036 adjustment.[92]

PIS Adjustment G decreases the distribution reservoirs account from $31,028 to $0 and increases the Storage Tanks account by $31,028, from $0 to $31,028. This adjustment simply transfers the balance to a more appropriate and more specific Storage Tanks Account.[93]

b. Other Rate Base Adjustments

Staff decreased Accumulated Depreciation by $4,922 from $234,721 to $229,799. Staff recalculated Accumulated Depreciation using the $168,539 balance approved in Decision No. 71317, adding 4 years of depreciation expense of $15,819 to arrive at an initial total Accumulated Depreciation of $231,815 at December 31, 2011. Staff then deducted $2,016 related to the removal of Well No. 2 addressed above. This deduction amount is based on the removal of $8,074, times 3.33 percent depreciation for an estimated 7.5 years of service for a recommended balance of $229,799.[94]

Staff decreased advances in aid of construction ("AIAC") by $30,986 from $30,986 to $0. This adjustment reflects the Company's assertion that it does not owe any refunds of AIAC under Main Extension Agreements or other obligations.[95]

Staff decreased customer deposits by $12,018 from $32,163 to $20,145. This adjustment reflects the amount of Customer Deposits due per the Company's supporting schedule.[96]

Staff increased accumulated amortization of CIAC by $44,957, from $36,981 to $81,938. In determining this adjustment Staff started with the balance established in Decision No. 71317 for

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[92] *Id.* at 13.
[93] *Id.*
[94] *Id.*
[95] *Id.*
[96] *Id.*

$42,983. To this balance, Staff added the annual CIAC amortization using an amortization rate of 3.9 percent as established in Decision No. 71317.[97]

Finally, Staff increased working capital by $13,812, from $0 to $13,812.[98]

Although these adjustments do not have any impact on rates in this case, it is important to make sure that these account balances are properly maintained should the Commission determine that rates should be set using a rate of return analysis in a future rate case.

2. Operating Income Adjustments

Staff made twelve operating expense adjustments to arrive at the recommended operating income of $2,770 mentioned above, which is based on revenues of $129,222 and expenses of $126,452.

Operating Income Adjustment A increases test year salaries and wages by $19,772 from $0 to $19,772 based on a two year average. This calculation now excludes the test year salaries and wages expense during the third year when the Company did not pay any salaries or wages.[99]

Operating Income Adjustment B decreases Purchased Water Expense by $686 from $686 to $0 for amounts that have been reclassified as Office Supplies and Expense. The amount reflects water purchased from the Company for use at the office.

Operating Income Adjustment C decreases Purchased Power Expense by $541 from $6,064 to $5,523. This amount reflects the amount that the Company was able to support with invoices.

Operating Income Adjustment D increases Chemicals by $8,140 from $711 to $8,851 to reflect a normalized amount of arsenic media costs. This increase reflects one year of arsenic media recovery.

Operating Income Adjustment E decreases Office Supplies and Expenses by $2,757 from $13,160 to $10,403. This amount reflects an amount of $9,717 that the Company was able to support plus $686 transferred in Operating Income Adjustment B.

Operating Income Adjustment F increases Outside Services Expense by $5,811 from $15,890 to $21,701. This adjustment reflects annualized expenses of $11,436 that were supported by the

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[97] *Id.* at 14.
[98] *Id.*
[99] Becker Resp. Test., Ex. S-2 at 4.

Company, and 75 percent of the non-rate case legal expenses of $13,686 or $10,265. Staff arrived at $13,686 by normalizing the $29,032.50 that the Company paid to Douglas Fitzpatrick and the $25,699 that the Company paid to Fennemore Craig over a four year period. Staff did an overall disallowance of 25 percent of this amount to address amounts related to correcting zoning violations that Staff believes the Company could have avoided.[100]

Operating Income Adjustment G increases Water Testing Expense by $800 from $1,000 to $1,800 to reflect application of Staff's recommended Water Testing Expense amount.

Operating Income Adjustment H decreases Insurance – General Liability by $2,526 from $4,948 to $2,422 to reflect those amounts the Company was able to support.

Operating Income Adjustment I increases Regulatory Commission Expense – Rate Case by $13,364 from $833 to $14,250. This adjustment is based on total estimated rate case expense of $57,000 amortized over four years.

Operating Income Adjustment J increases Depreciation Expense by $1,759 from $7,367 to $9,126 in order to properly reflect application of Staff's recommended depreciation rates to the plant balances that Staff is recommending in this case.

Operating Income Adjustment K decreases Taxes Other than Income by $10,291 from $10,291 to $0 for sales tax collections that are a pass-through to the ratepayers rather than an expense.

Finally, Operating Income Adjustment L increases income taxes by $50 from $0 to $50 to reflect the application of statutory state and federal income tax rates to Staff's test year taxable income pursuant to recent Commission policy changes regarding ratemaking treatment of income taxes for limited liability companies.

3. Revenue Requirement

In this case, Staff is not basing its recommendation on a standard rate of return methodology. As the testimony demonstrates, Staff's analysis suggests that MRWC's rate base is too low to provide meaningful returns using an ordinary return on rate base approach. Considering that the largest driver of the current rate application is the acquisition of new debt to pay for necessary arsenic treatment

[100] Ex. S-4.

plant and, after the amendment of the financing, the construction of 80,000 gallons of new storage, Staff premised its return recommendation on a cash flow analysis and Debt Service Coverage ("DSC") analysis.[101] Staff's recommendation is to provide the Company with sufficient cash flows to meet its debt service obligations with a small amount of cash to cover contingencies. Staff's recommendation produces a 4.11% rate of return on original cost rate base which is being used as fair value rate base.

Staff recommends that the Commission provide retroactive approval of the long term debt associated with the two capital leases entered into by the Company for the construction of the arsenic treatment system and the building that houses it.

a. Arsenic treatment is required by ADEQ

Regardless of the means used to approve the financing of arsenic treatment, the unavoidable fact remains that MRWC must provide arsenic treatment in order to provide the drinking water service that it is certificated for. The US EPA has mandated a revision of the arsenic standard that lowered the acceptable level of arsenic in drinking water. As the state environmental agency, ADEQ has the authority to enforce drinking water standards imposed by EPA and has already found the Company in violation of its requirements.

The Commission has determined that it is appropriate to set rates for MRWC to permit the recovery of plant costs associated with meeting the arsenic standard.[102] ADEQ has not waived the arsenic requirement for MRWC and removing the contaminant from drinking water remains a health and safety concern. Consequently, it is reasonable and appropriate to approve MRWC to obtain financing necessary to construct facilities that will permit it to comply with the arsenic standards.

b. The cost estimates for the plant are reasonable

The Company's three financing applications made on May 31, 2012 request approval to recover the debt associated with a $69,592 loan for Rask Construction to install a water line connecting Well No. 4 to Well No. 1, a $21,377 sum for the purchase of the Well No. 4 site and a company vehicle and $15,000 associated with the purchase of an 8,000 gallon hydro-pneumatic tank.

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[101] Becker Dir. Test., Ex. S-1 at 8-9; Becker Resp. Test., Ex. S-2, attached Schedule GWB-5.
[102] *See, e.g.,* Decision No. 71317 at 21-22.

On April 12, 2013, the Company amended its application to incur long term debt associated with constructing four 20,000 gallon storage tanks, the arsenic treatment system, and the building that houses the arsenic treatment system.

Staff analyzed the cost estimates and the costs already incurred in relation to the arsenic treatment facility as well as the 80,000 gallons of additional storage. In Staff's view, the costs are reasonable for plant of that size.[103] Staff recommends approval of the Company to incur $108,000 in WIFA loans to pay for the construction of the new storage. Staff's evaluation demonstrates that the Company can make its debt service coverage in the event that the Staff recommended rates and surcharges are approved.

Additionally, Staff's analysis of the $8,000 Nile River Leasing lease for the building that houses the ATS indicates that this amount is appropriate.[104] Regarding the ATS, Staff recommends that the arsenic treatment media be separated from the system costs and be recovered instead through Chemicals Expense. Consequently, Staff is recommending approval of only $21,720 of the ATS for financing and that the remaining $16,280 of the total $38,000 originally requested for the ATS be recovered by depreciating it over 24 months and including one year of media expense as part of Chemicals Expense.[105] As Staff is recommending approval of the financing, Staff is also recommending granting retroactive approval for MRWC to have incurred the debt associated with the Nile River and Financial Pacific leases.[106] Staff recommends allowing the Company to use a surcharge to fund debt service on the WIFA loan.[107] Staff's recommendation embeds the costs related to the Nile River and Financial Pacific leases within base rates.[108]

Staff found that the 8,000 gallon hydro-pneumatic tank is appropriate and necessary and that the costs should include an additional $3,541 beyond the $15,000 for acquisition of the tank.[109] Staff

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[103] Becker Dir. Test., Ex. S-1, attached Engineering Memorandum of Scott at 21; Tr. at 742.
[104] Becker Dir. Test., Ex. S-1, attached Engineering Memorandum of Scott at 21.
[105] Becker Dir. Test., Ex. S-1 at 20-21.
[106] *Id.* at 22.
[107] *Id.*
[108] Exhibit S-5, Schedule GWB-4.
[109] Becker Dir. Test., Ex. S-1 at 18-19.

recommends implementing a second surcharge to collect the $18,541 total through monthly payments over a five year period.[110]

However, Staff's engineering analysis concluded that the transmission line connecting Well No. 4 and Well No. 1 is not used and useful owing to the lack of current Yavapai County approvals and because Well No. 4 and Well No. 1 were never connected.[111] With respect to the Well No. 4 site, Staff recommends that the Commission deny approval of the debt associated with this transaction because the well is not in service.[112] Staff agreed that the company vehicle is used and useful but as it is already included within the plant in service, it is already a part of rate base and as such, approval of the financing for the vehicle would be inappropriate.[113] Consequently, Staff recommends disallowing the inclusion of the debt associated with Well No. 4 in rates at this time.

c. Cancellation of the Performance Bond

Pursuant to Commission Decision No. 67583, which is the decision that approved the sale of the Company assets to its current owners, the Company was required to obtain, and maintain a surety bond. The purpose of this bond was to ensure the financial ability of the Company to maintain operations. According to the Company, the annual cost of this bond is $1,500,[114] but is due to increase to $4,500 in 2013. The Company requested in its Rebuttal Testimony that the revenue requirement be increased to cover this additional expense, or in the alternative that the Commission eliminate the requirement to maintain this bond.[115] Staff agrees with the elimination of this requirement since the original purpose of the bond no longer exists. In short, this transfer occurred in 2006 and the Company continues to provide service to its customers.[116]

4. Rate Design

For residential customers, the monthly minimum for 5/8" x 3/4" is $30, 3/4" is $45, and 1" is $75. In this case for all customers, there are three tiers for the recommended commodity rates. Tier one for a 5/8" x 3/4" customer is 1 gallon to 3,000 gallons at the commodity rate of $2.50 per 1,000

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[110] *Id.* at 19.
[111] Becker Dir. Test., Ex. S-1 attached Memorandum of Scott at 20, Paragraph J.
[112] Becker Dir. Test., Ex. S-1 at 17.
[113] *Id.* at 17-18.
[114] Olsen Rebuttal Test., Ex. A-3 at 6.
[115] *Id.*at 7.
[116] Becker Resp. Test., Ex. S-3 at 3.

gallons.[117] Tier two is 3,001 gallons to 9,000 gallons at the commodity rate of $4.17 per 1,000 gallons.[118] Finally, Tier three is all gallons over 9,000 at the commodity rate of $6.67 per 1,000 gallons.[119] Under Staff's recommended rates, with a median residential usage of 4,112 gallons, a 5/8" x 3/4" meter customer would experience an $8.60 or 25.6 percent increase in his monthly bill from $33.53 to $42.13.[120]

5. Miscellaneous

a. Service Charges

Staff recommends approval of the following service charges:

Establishment	$40.00
Reconnection (Delinquent)	$50.00
Service Charge – After hours at customer request	$35.00
Meter Test (If Correct)	$30.00
NSF Check	$25.00
Deferred Payment (Per month)	1.50%
Meter Reread	$15.00

In addition, Staff recommends continuation of the monthly service charge for fire sprinklers, which is 1% of the monthly minimum for a comparably sized meter connection, but no less than $5.00. Further, Staff recommends that deposits and deposit interest should be calculated pursuant to A.A.C. R14-2-403(B). The Company is in agreement with Staff's recommendations regarding Service Charges.[121]

b. NARUC Bookkeeping

Staff also recommends that the Company keep its books and records in accordance with NARUC standards.[122] Staff recognizes that the Company was already required to meet this requirement by Decision No. 67583 and by Commission Rule R14-2-411(D)(2). Notwithstanding

[117] Exhibit S-5, Schedule GWB-7.
[118] *Id.*
[119] *Id.*
[120] Becker Resp. Test., Ex. S-2 at 6.
[121] Tr. at 412-13.
[122] *Id.* at 874-75.

that, Staff perceives a value in reminding smaller water utilities of the requirement to encourage steady improvement in their bookkeeping practices.

C. Staff's Analysis of Complaint Issues

In addition to the rate case matters, Mr. Dougherty has leveled a number of allegations against the Company in his Complaint as amended and supplemented that were brought into the rate case when the matters were consolidated. As Mr. Dougherty ultimately voluntarily dismissed a number of his original Complaint allegations, Staff will only comment on those allegations that still remained at the time of the evidentiary hearing.

In addition to the particular responses provided to each allegation, Staff would note that Mr. Dougherty is not a ratepayer of MRWC. As such, he does not suffer an "injury in fact" by the Commission's approval for the Company to charge a rate or debt to finance plant. For that reason, Mr. Dougherty lacks standing to pursue any claims based on the Commission's rate or financing based approvals.[123]

Standing means a party has sufficient stake in an otherwise justiciable controversy to obtain judicial resolution of that controversy.[124] With regard to his rate case issues, Mr. Dougherty clearly fails to satisfy any of the requirements to show he has a tangible stake in the rates that the Commission approves for MRWC. As a person who is not and will not be paying the rates the utility charges, Mr. Dougherty does not have a concrete and particularized interest in the rates that he is not being charged and will not be charged. At hearing, Mr. Dougherty has suggested that he *might* become a ratepayer of MRWC.[125] This posits a hypothetical circumstance that is clearly an inadequate stake in the Company's rates to establish standing to contest rate issues.

The Commission did not create the requirement that the Company obtain arsenic treatment facilities. Likewise, the Commission does not regulate the construction or operation of wells which

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[123] Staff acknowledges that Mr. Dougherty has been granted intervention and Staff did not oppose the intervention. Staff would distinguish, however, that access to the forum does not of itself grant a party sufficient stake in a matter to confer standing to press a claim with regard to that particular matter.

[124] *See* Black's Law Dictionary definition for "Standing"; *see also United States v. Hayes*, 515 U.S. 737, 743 (1995) (providing that standing requires an injury-in-fact that is particularized and concreted as opposed to hypothetical, is causally connected to the conduct complained of, and will be redressed by a favorable decision.)

[125] Tr. at 763, 836.

are the underlying issues of concern to Mr. Dougherty.[126] Rather, the Commission is charged with setting rates by which a utility may satisfy requirements placed on it in order to provide service, including complying with regulatory requirements set by other agencies. As such, the Commission's approval of rates to MRWC that may permit recovery of its expenses related to Well No. 4 is not the cause of Mr. Dougherty's injury.[127]

For those reasons, Staff maintains that Mr. Dougherty lacks standing to pursue any of the allegations relating to obtaining approvals for financing and the mischarging of rates by the Company. As will be explained in Staff's analysis of the individual allegations of Mr. Dougherty's complaint, there are alleged violations that likewise suffer from standing issues for particular reasons as well.

From a practical perspective, Staff would observe that the relief requested by Mr. Dougherty does not alleviate any of the issues that he has raised as the basis for his complaint. Arizona Water Company ("AWC"), which Mr. Dougherty views as preferable to MRWC as the utility serving the Company's service territory, will have the same environmental issues confronting it if it were to assume control over MRWC, either by purchasing MRWC or by the Commission installing it as an interim manager.[128]

The arsenic treatment and water sources supplying AWC's Rimrock system which abuts MRWC's service area is only able to serve AWC's system during peak usage months. AWC does not have the ready ability to provide drinking water service within the MRWC service territory.[129] Consequently, AWC would have to employ the water sources and treatment facilities already within

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[126] ADEQ regulates the operation of wells used by a public water system (*See, e.g.,* A.R.S. § 49-104(7)) and Arizona Department of Water Resources regulates the use of groundwater per A.R.S. § 45-103.

[127] Moreover, the well has already been constructed and both Staff and the Company have agreed that it should be excluded from rate base as not used and useful. Therefore, the Company is not requesting rates to permit recovery of the costs associated with the well.

[128] Staff reiterates from previous oral statements given in separate applications related to the Complaint Proceeding that the principal reason for Staff's decision not to pursue enforcement against the Company to date has been that Staff generally does not "kick the legs out from under" utilities that are making the effort to come into compliance. In that vein, the absence of a means to alleviate the issues Mr. Dougherty complains of through pursuit of enforcement reinforces Staff's view that enforcement under these circumstances does not advance Staff's paramount interests in restoring the utility to a condition of providing safe and reliable service to its ratepayers.

[129] *See, e.g.,* tr. at 743-44 testimony of Marlin Scott Jr. explaining that Arizona Water Company would have to develop separate water sources if it were serve in MRWC's CC&N and that interconnection is not an immediately feasible possibility.

the MRWC territory, or construct new facilities that would be placed within the MRWC territory.[130] As the existing facilities appear to be the underlying basis for much of the antagonism between Mr. Dougherty and the Company, the requested relief of removing MRWC and bringing in AWC likely will not improve the conditions that Mr. Dougherty finds objectionable.

More immediately, Mr. Dougherty has not articulated a method by which his requested relief can occur. Mr. Dougherty has failed to demonstrate facts sufficient to justify instituting an interim manager under the circumstances. Mr. Dougherty has also failed to meet the hefty burden that is necessary in order to cancel an existing CC&N that would permit AWC to acquire the service territory over the objections of MRWC. The evidence provided at hearing,[131] including emails produced by Mr. Dougherty,[132] confirms that even if the CC&N were not an obstacle to AWC's entry into the territory, AWC has an unwillingness to acquire an existing utility over the target utility's objections.

Consequently, Mr. Dougherty's complaint suffers from fundamental flaws in that he lacks standing to assert many of the alleged violations, the relief that he requests cannot be granted and even if it could, it would not produce the outcome that he desires.

1. Count I – The Company failed to disclose a $32,000 debt incurred in 2005 on utilities annual reports filed in subsequent years.

The evidence on this point is contested insofar as it is unclear that the $32,000 acquisition of the lot on which Well No. 4 is situated involved the use of long term debt. The allegation asserts that the Company has been filing "materially" incorrect utility annual reports for a number of years. The threshold of materiality is that the information provided is substantial and important, that is to say that it was more or less necessary or that it had some influence or effect on the merits. [133]

As explained in the testimony of Mr. Becker, Staff assumes a certain degree of imprecision with regard to information provided by A.R.S. §40-204 annual reports.[134] The charge of the statute is

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[130] *Id.*
[131] *See, e.g.,* Exhibit A-24, email from William Garfield to Todd Wiley.
[132] *See, e.g.,* Exhibit C-5, letter from William Garfield to Commission Staff dated August 9, 2004 noting interest in acquiring MEPOA system if the owner is likewise interested.
[133] *See* Black's Law Dictionary definition for "Material".
[134] Transcript of June 25, 2013 evidentiary hearing at 881:22-883:1, consolidated Docket No. 12-0204.

that the annual reports conform in format and content to what Staff and the Commission requires. Consequently, the principal importance of utility annual reports is as an **unaudited** "snapshot" of a utility's condition.

Because it is unaudited, Staff typically does not rely on the annual report when undertaking a regulatory audit, such as the one Mr. Becker performed in preparing Staff's rate recommendations.[135][136] In fact, Staff did not rely on the annual reports for the financial data contained therein. Rather, Staff obtained the information relied upon for the regulatory audit through data requests and an on-site inspection of the Company's books.[137] Consequently, any alleged inaccuracy of the annual reports on this issue is not material.

Further, in this circumstance, the only entity harmed by not providing accurate annual reports is the Company. To the extent that it carried an unapproved debt for a number of years, it was not able to recover the costs of the debt through rates. Effectively, the utility was burdening itself with the sole responsibility for paying off the debt.

To the extent that Mr. Dougherty may advance the argument that there was a willful attempt to deceive Staff, the testimonies of Ms. Olsen and Mr. Campbell amply demonstrate that they are not utility accounting experts.[138] There is sufficient evidence in the record for the Commission to reach the conclusion that the alleged inaccuracy of the annual reports was unintentional. Because Staff did not rely on unaudited annual report financial data when it produced its rate recommendations, it is clear that the inaccuracy of the annual reports was not material.

Finally, assuming that the $32,000 is in fact long-term debt that should have been reported in the annual report, Mr. Dougherty is not a ratepayer of the Company. As such, he is not being asked to bear a share of recovering any amount of utility expense regardless of whether it was appropriately reported. For this and all the stated reasons, Mr. Dougherty has failed to establish a violation with relation to Count I.

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[135] Tr. at 877-80.

[136] However, the annual report may be useful to Staff analysts performing other functions, such as engineering. Tr. at 1062.

[137] *Id.* at 877-80.

[138] *See, e.g., id.* at 563-64; *see also* ex. A-1 Resumé of Patricia Olsen.

2. Count II – The Company failed to disclose material financial information to Commission Staff during a 2009 audit performed in evaluating the appropriateness of the Company's last general rate case.

For similar reasons as were articulated in response to Count I, Mr. Dougherty has failed to meet any of the elements to demonstrate a violation occurred in Count II.

This Count cryptically links the failure to disclose information to recommendations made by Staff regarding the Company's ability to qualify for WIFA loan financing. The allegation does not make sense on this point. If the failure to disclose material financial information, such as additional debt obligations, made the Company less capable of supporting the debt service obligation associated with an additional $165,000 in WIFA financed debt, the Company's rates would be set too low. Until MRWC obtained approval for an increase in rates to properly account for additional debt on its books, the Company alone would bear the cost of the attrition in revenues due to supporting more debt than its last rate case revenue requirement contemplated. Consequently, the Company would not recover the cost of any expenses it failed to disclose, and the nondisclosure is immaterial.

The claim fails to explain how any entity other than the Company is injured in the event that the factual underpinnings of this allegation prove true. As stated for Count I and equally applicable to this Count as well, as Mr. Dougherty is not paying rates to MRWC, and he is not injured by whether the rates are set too low for the Company to pay for the debts it incurs. As Mr. Dougherty's interests involve preventing Well No. 4 from going into operation, it is unclear how, if at all, proving this allegation advances Mr. Dougherty's interests.

Additionally, the amended Count II added the contention that this failure to disclose the debts to Staff constitutes a violation of A.R.S. § 40-301, -302 and A.A.C. R14-2-411(D)(1) and (2). A.R.S. § 40-301 and -302 do not require notification to Staff of debts. Rather they require a utility to obtain Commission approval of long term debt. Failure to notify *Staff* of the existence of additional debt would not constitute violation of A.R.S. § 40-301 or -302.

Regarding potential violations of A.A.C. R14-2-411(D)(1) and (2) as explained by Mr. Becker, determining compliance with NARUC accounting standards is difficult and is largely subjective.[139] Also, based on Staff's review of the Company's records, there was sufficient record

[139] Tr. at 1060-61.

support to substantiate most of its plant costs and expenses. For those plant costs and operating expenses that were not supported with invoices or other documentary support, Staff recommended disallowance of the recovery in rates to the extent that the amounts were not supported. While less than perfect, the state of the Company's records does not rise to the level of violating A.A.C. R14-2-411(D) because the appropriate response is to adjust rates accordingly.

3. Count IV – The Company's inclusion of Well No. 4 as part of its Water Company Plant Description in the 2007 through 2010 utility annual reports without having obtained Yavapai County zoning approval to operate the well violates Decision Nos. 67583 and 71317 and A.A.C. R14-2-411(D)(1) and (2).

According to Mr. Dougherty, Count IV "demonstrates the Company's failure to accurately describe its asset base while understating its liabilities by selectively choosing which information to include, or not include, in its Annual Reports."[140] With regard to the assertion that this violates A.A.C. R14-2-411(D), Staff reiterates its discussion of Counts I and II.

Mr. Dougherty further suggests that the factual circumstances of Count IV indicate a violation of Decision Nos. 67583 and 71317. Regarding Decision No. 67583, the order incorporates the same requirement as A.A.C. R14-2-411(D)(2) that the Company maintain its books in compliance with NARUC standards. To that end, Staff will point out, in addition to its discussion of A.A.C. R14-2-411(D)(2) requirements, that the outside regulatory treatment of plant assets owned by the utility is not a NARUC requirement. The annual reports acknowledge the existence of Well No. 4 and its costs, which is the extent of the requirement for the annual report. Whether it was classified to the proper account is a NARUC issue and as noted in the discussion of Count II, proper classification of plant can be subjective. Highlighting the regulatory approvals of plant is not a NARUC accounting requirement and consequently, the facts provided by Mr. Dougherty at hearing fail to demonstrate a violation of Decision No. 67583.

With regard to Mr. Dougherty's contention that there has been a violation of Decision No. 71317, Staff does not see any provision of Decision No. 71317 that is implicated by this allegation. Decision No. 71317 contains no requirements regarding the reporting of Yavapai County approvals. Further, the only change to the Company's annual report requirement is that the Decision ordered

[140] Dougherty Dir. Test., Ex. C-92 at 9.

MRWC to begin filing affidavits to the effect that it is current on its property taxes. As such, Mr. Dougherty has failed to show a violation of Decision No. 71317 on the basis of the allegations contained in Count IV.

4. Count VII – The Company has failed to provide adequate service to customers by providing water that is in violation of state and federal arsenic standards.

Count VII alleges that the Company has failed in its obligation to provide adequate service to ratepayers by providing water that is in violation of state and federal arsenic standards. Mr. Dougherty lacks standing to press this claim as he is not a ratepayer of the Company as discussed earlier. On the merits, the evidence provided in the hearing shows that the Company is not in violation of state and federal arsenic standards.

The water MRWC provides has been above the arsenic standard required by the EPA. While ADEQ, which administers the EPA arsenic standards in Arizona, has prepared Notices of Violation ("NOV") against the Company for not having achieved compliance with the arsenic standard to date, ADEQ has also continuously issued consent orders for those NOVs.[141] As ADEQ has granted consent orders for the NOVs, the Company is and has been in compliance with ADEQ.[142] Effectively, ADEQ has granted an extension to MRWC to come into compliance with the arsenic standard. Consequently, the agency primarily charged with enforcing those standards is not currently pursuing MRWC for any alleged violations.

5. Count VIII – The Company is in violation of Decision No. 71317 for failure to obtain an ADEQ "Certificate of Approval" for Well No. 4.

Although it was not dismissed by Mr. Dougherty in his Amended Complaint, Mr. Dougherty did not discuss Count VIII in his Direct Testimony. Staff will respond to this allegation to the extent that it is still being raised in this proceeding.

Staff agrees that the Company is presently in a state of noncompliance with Decision No. 71317 regarding the requirement to obtain ADEQ Approval of Construction for its arsenic treatment system by April 30, 2010.[143] However, Decision No. 71317 was reopened pursuant to A.R.S. § 40-

[141] *See, e.g.,* exhibits A-11 (ADEQ Consent Order dated June 7, 2010) and A-12 (Amendment to ADEQ Consent Order dated June 2, 2011).
[142] Tr. at 491.
[143] Decision No. 71317 at 21.

252 and remains open. Therefore, the Commission may consider and approve modifications to the requirement, including extending the compliance date. Until the Commission reaches a final determination on how, if at all, to modify Decision No. 71317, pursuing a violation of the Decision on this point is premature.

6. Count X – The Company provided misleading information to Commission "investigators" in January 2010 concerning Yavapai County zoning issues related to Well No. 4.

Count X alleges that the failure of the Company to disclose the lack of approvals from Yavapai County in response to a Staff request for information regarding permits for the operation of Well No. 4 constitutes a violation of A.A.C. R14-2-411.[144] Mr. Dougherty does not have standing to press this claim. Staff, the party allegedly deceived, is not seeking any relief related to the data request at issue herein.

Staff agrees that it is preferable to receive accurate information in response to its requests for information. Staff does not believe, however, that the inaccuracy alleged herein rises to the level of a violation of any provision of A.A.C. R14-2-411 without some indication of deliberate deceit. Staff would note that in this circumstance there was an ongoing legal dispute as to whether Yavapai County approval was necessary.[145] A bona fide legal uncertainty that was being actively litigated prevents reaching a conclusion that the nondisclosure of the lack of Yavapai County permits was deliberate deceit. Consequently, Mr. Dougherty has failed to perform the necessary showing to demonstrate a violation in relation to Count X.

7. Count XI – The Company mischarged the arsenic surcharge in November of 2009.

Count XI asserts that the Company mischarged an arsenic surcharge in November of 2009. Staff asserts that Mr. Dougherty does not have standing to pursue this issue as he is not a ratepayer of the Company.

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[144] Staff assumes that Mr. Dougherty intends Exhibit 18 attached to the original complaint docketed on August 23, 2011 as support for the allegation, Docket No. W-04254A-11-0323. However, Staff's review of the evidentiary record in this matter could not locate where, if at all, this exhibit was offered in evidence. Likewise, Staff could locate no reference in the oral testimony provided during the evidentiary hearing speaking to this claim. Consequently, Mr. Dougherty has failed to provide any evidentiary support for the claim.

[145] *See, e.g.,* exhibit C-57, Yavapai Superior Court Ruling regarding Yavapai County Water Well Code.

Although the Company has admitted that the surcharge was invoiced in its answer to the Complaint,[146] there was no consumer complaint with regard to a mischarge during that time period. Staff will note that the Company's answer to the allegation is only that the surcharge was invoiced and not that it was collected. Mr. Dougherty alleged in the Complaint that the surcharge was collected but has not supplied any evidence in the record to substantiate that a ratepayer actually paid the improper charge. What is clear is that Mr. Dougherty was not charged as he is not a ratepayer of MRWC.

If the Commission concludes that an overcharge occurred, a refund to the customers that were overcharged could be an appropriate remedy.

8. Count XII – The Company mischarged the arsenic surcharge in April 2011.

Similar to Count XI, Count XII alleges a mischarge of the arsenic surcharge, this time occurring in April of 2011. Again, Staff asserts that Mr. Dougherty lacks standing to press this claim as he is not a ratepayer of the utility and was not charged the alleged mischarge.

MRWC has admitted to having mischarged the arsenic surcharge in April of 2011.[147] Additionally, Staff received an informal Complaint with regard to the mischarge.[148] The evidence in the record is that the Company has refunded the monies collected pursuant to this mischarge of the arsenic surcharge.[149] Therefore, the record on this matter demonstrates that the mischarge has been addressed and Mr. Dougherty has failed to establish any merit to Count XII.

9. Count XV – The Company failed to immediately report to the Commission that the Company's records had been stolen during a series of burglaries that allegedly began in October 2009 and continued into 2010.

Count XV alleges that the Company failed to report theft of Company records to the Commission. Mr. Dougherty characterizes the allegation as a failure to maintain the Company's

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[146] Company Answer to Amended Complaint filed March 18, 2013 at 8, consolidated Docket No. W-04254A-12-0204.
[147] *Id.*
[148] Staff Notice of Filing Informal Complaint Report filed July 25, 2011, Docket No. W-04254A-08-0361.
[149] Tr.at 124.

books and records in conformance with NARUC uniform system of accounts and the failure therefore constitutes a violation of Decision No. 67583.[150]

There is no duty on the part of a utility to report thefts to the Commission. The requirement to maintain books in a manner compliant with NARUC standards does not create a duty to report thefts. Moreover, the theft of records does not have a bearing on whether a utility's books are maintained in accordance with NARUC. NARUC uniform system of accounts is an accounting standard and reflects how costs and expenses are booked to accounts that are classified by type of expense.[151] As such, NARUC uniform system of accounts is a methodology.

Count XV mistakenly conflates NARUC standards with something akin to a government body's record retention requirement. Consequently, Count XV misstates the obligations that a utility must operate under and therefore Mr. Dougherty has not provided evidence sufficient to show a violation of any legal requirement based on the allegation.

10. Count XVII – The Company violated A.R.S. §40-301, -302, -424, and -425 by incurring debt by entering lease agreements without first obtaining Commission approval.

Although Staff has discussed previously in response to ALJ Question 2 the view that the Commission can grant retroactive approval to long term debt, Staff would agree that until such approval is granted, the Company could be viewed as having violated A.R.S. § 40-301 and -302. While there is a request pending for retroactive approval of the debt the Company has entered, it is premature to pursue a violation of A.R.S. § 40-301 and -302.

With respect to A.R.S. § 40-424 and -425, the allegations must fail because it is not possible for the Company to violate either statute. Neither statute establishes a requirement of the utility. Rather, A.R.S. § 40-424 and -425 are sources of Commission authority to penalize.

IV. Conclusion

For all the above stated reasons, Staff recommends that the Commission approve the requested rate increase and financings consistent with the recommendations of Staff. With respect to

[150] Amendment to Complaint filed September 13, 2011 at 2, Docket No. W-04254A-11-0323.
[151] Tr. at 1061.

the Complaint Proceeding, Staff recommends that the Commission find that Mr. Dougherty has failed to meet his burden in establishing the elements of any of his allegations.

RESPECTFULLY SUBMITTED this 30th day of August, 2013.

Charles H. Hains
Wesley C. Van Cleve
Attorneys, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Original and thirteen (13) copies
of the foregoing filed this
30th day of August 2013, with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Copy of the foregoing EMAILED this
30th day of August, 2013, to:

Todd C. Wiley - twiley@fclaw.com
Patricia Olsen – patsy@montezumawater.com
John E. Daugherty, III – jd.investigativemedia@gmail.com
John Hestand – environmental@azag.gov

Copy of the foregoing mailed this
30th day of August, 2013, to:

Todd C. Wiley
FENNEMORE CRAIG
2394 East Camelback Road, Suite 600
Phoenix, Arizona 85016-3429

Patricia D. Olsen
Montezuma Rimrock Water Co.
P.O. Box 10
Rimrock, Arizona 86335

John E. Dougherty III
P.O. Box 501
Rimrock, Arizona 86335

John Hestand
Office of the Attorney General
1275 West Washington
Phoenix, Arizona 85007